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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF CALIFORNIA  
SAN JOSE DIVISION

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KINGSLEY EZEUDE and CHUKWUKA  
OBI on behalf of themselves and all others  
similarly situated,

Plaintiffs,

v.

PAYPAL, INC. and PAYPAL  
HOLDINGS, INC.,

Defendants.

Case No. 5:17-cv-02558-LHK

CLASS ACTION

**NOTICE OF MOTION AND MOTION TO  
DISMISS COMPLAINT; MEMORANDUM  
OF POINTS AND AUTHORITIES IN  
SUPPORT THEREOF**

Date: January 4, 2018  
Time: 1:30 p.m.  
Judge: Honorable Lucy H. Koh  
Courtroom: 8

## **NOTICE OF MOTION AND MOTION**

**PLEASE TAKE NOTICE** that on January 4, 2018, at 1:30 p.m., or as soon thereafter as the matter may be heard, in the Courtroom of the Honorable Lucy H. Koh, at 280 South 1st Street, San Jose, California 95113, Defendants PayPal, Inc. and PayPal Holdings, Inc. (together, “PayPal”) will and hereby do move the Court for an order dismissing Plaintiffs’ Complaint. This motion is made pursuant to Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure on the grounds that the Amended Complaint fails to state a claim and fails to comply with Rule 9(b).

PayPal respectfully requests that the Court dismiss Plaintiffs' Complaint. The motion is based on this Notice and the Memorandum of Points and Authorities below; the accompanying Request for Judicial Notice and exhibits attached thereto; the papers on file in the action; argument of counsel at the hearing; and other such matters as may be judicially noticed or come before the Court at the hearing on this matter.

## **STATEMENT OF ISSUES TO BE DECIDED**

1. Whether Plaintiffs' claim for aiding and abetting fraud should be dismissed because:

- a. Plaintiffs' claim is not plausible in light of their own allegations that PayPal took actions that hindered Charles Scoville's ("Scoville") operation of Traffic Monsoon, LLC ("Traffic Monsoon");
- b. Plaintiffs fail to sufficiently allege that PayPal actually knew of Scoville and Traffic Monsoon's alleged fraud;
- c. Plaintiffs fail to allege with particularity that PayPal intentionally and substantially assisted the commission of the alleged fraud;
- d. Plaintiffs do not plead the underlying fraud with particularity because they fail to allege that they actually relied on any alleged misrepresentation or omission by Scoville or Traffic Monsoon.

2. Whether Plaintiffs' claim for aiding and abetting breach of fiduciary duty should be dismissed because:

a. As with their claim for aiding and abetting fraud, Plaintiffs' claim is not

plausible, Plaintiffs fail to sufficiently allege that PayPal actually knew of Scoville and Traffic Monsoon's alleged breach of fiduciary duty, and fail to allege with particularity that PayPal intentionally and substantially assisted the alleged breach;

b. Plaintiffs plead no facts establishing that PayPal knew that Traffic Monsoon owed fiduciary duties to its customers.

3. Whether Plaintiffs' claim for violation of California Corporations Code § 25504

should be dismissed because:

- a. Plaintiffs do not allege an offer or sale of securities in California;
- b. Plaintiffs do not allege facts sufficient to show that PayPal materially assisted Scoville and Traffic Monsoon to sell or offer to sell securities to Plaintiffs through the use of false and misleading statements;
- c. Plaintiffs fail to allege any facts showing that PayPal intended to induce Plaintiffs to rely on representations it knew to be false or misleading.

4. Whether Plaintiffs' claim for negligence should be dismissed because:

- a. By agreeing to the PayPal User Agreement, Plaintiffs expressly released PayPal from liability for injuries arising directly or indirectly from third parties;

b. As a payment service processor, PayPal owed no legal duty of care to Plaintiffs vis-à-vis Traffic Monsoon or other merchants using PayPal's services, and Plaintiffs otherwise fail to allege sufficient facts showing that PayPal had a duty to protect them from harm allegedly caused by Scoville and Traffic Monsoon;

c. Plaintiffs have alleged no facts establishing an exception to the economic loss rule, which bars negligence claims for purely economic loss.

5. Whether Plaintiffs' claim for gross negligence should be dismissed because California does not recognize a common law cause of action for gross negligence separate from negligence.

## 1 TABLE OF CONTENTS

	Page
3 INTRODUCTION .....	- 1 -
4 FACTUAL BACKGROUND .....	- 3 -
5 I. PayPal And Its Business .....	- 3 -
6 II. Traffic Monsoon and Charles Scoville .....	- 4 -
7 III. PayPal Unilaterally Limits Traffic Monsoon's PayPal Account .....	- 4 -
8 IV. The SEC Files Suit Against Traffic Monsoon And Scoville .....	- 5 -
9 V. The Certified Interlocutory Appeal Before The Tenth Circuit .....	- 6 -
10 VI. Unable To Sue Traffic Monsoon Or Scoville, Plaintiffs Sue PayPal Instead.....	- 6 -
11 ARGUMENT .....	- 7 -
12 I. Plaintiffs Fail To Plead With Particularity That PayPal Aided And Abetted Traffic 13 Monsoon And Scoville's Alleged Fraud.....	- 7 -
14 A. Plaintiffs' Aiding And Abetting Claim Is Implausible .....	- 8 -
15 B. Plaintiffs Fail To Adequately Plead That PayPal Had Actual 16 Knowledge Of Traffic Monsoon And Scoville's Alleged Fraud .....	- 9 -
17 1. Knowledge That Traffic Monsoon Was A Pay-To- 18 Click Business Operated By Scoville Cannot Establish Actual Knowledge That Traffic Monsoon 19 Was A Ponzi Scheme .....	- 10 -
20 2. Knowledge Of Unusual Account Activity Cannot Establish Actual Knowledge That Traffic Monsoon 21 Was A Ponzi Scheme .....	- 11 -
22 3. Knowledge That AdPacks Were Variously Called 23 "Investments" And "Revenue Sharing Positions" Cannot Establish Actual Knowledge That Traffic 24 Monsoon Was A Ponzi Scheme .....	- 13 -
25 C. Plaintiffs Fail To Adequately Plead That PayPal Intentionally And 26 Substantially Assisted Traffic Monsoon And Scoville's Alleged Fraud .....	- 14 -
27 D. Plaintiffs Fail To Plead The Alleged Underlying Fraud With 28 Particularity .....	- 16 -

## TABLE OF CONTENTS (continued)

		Page
2	II. Plaintiffs' Claim For Aiding And Abetting Breach Of Fiduciary Duty Fails.....	16 -
3	III. Plaintiffs' Claim Under Cal. Corp. § 25504.1 Fails.....	18 -
4	A. Plaintiffs Fail To Allege An Offer Or Sale Of A Security In California .....	18 -
5	B. Plaintiffs Fail To Allege Facts Showing That PayPal "Materially Assisted" Traffic Monsoon's Alleged Violation Of Section 25401 .....	19 -
6	C. Plaintiffs Fail To Allege Facts Showing That PayPal Acted With An "Intent To Deceive Or Defraud" Plaintiffs .....	20 -
7	IV. Plaintiffs' Claim For Negligence Fails .....	21 -
8	A. Plaintiffs' Negligence Claim Is Barred By The PayPal User Agreement.....	21 -
9	B. Even If Plaintiffs Did Not Waive Their Right To A Claim For Negligence, PayPal Did Not Owe Them A Duty Of Care Vis-à-vis Traffic Monsoon And Scoville.....	22 -
10	C. Plaintiffs' Negligence Claim Is Also Barred By The Economic Loss Rule .....	24 -
11	V. Plaintiffs' Claim For Gross Negligence Is Not Cognizable.....	25 -
12	CONCLUSION.....	25 -

## **TABLE OF AUTHORITIES**

Cases	Page(s)
<i>Adam v. Silicon Valley Bancshares</i> , 1994 WL 619300 (N.D. Cal. Feb. 8, 1994) .....	8
<i>In re Agape Litig.</i> , 773 F. Supp. 2d 298 (E.D.N.Y. 2011) .....	13, 14
<i>Architectural Res. Grp., Inc. v. HKS, Inc.</i> , 2013 WL 568921 (N.D. Cal. Feb. 13, 2013) .....	25
<i>Arroyo v. Chattem, Inc.</i> , 926 F. Supp. 2d 1070 (N.D. Cal. 2012) .....	16
<i>Ashcroft v. Iqbal</i> , 556 U.S. 662 (2009).....	7, 8, 16
<i>Baltazar v. Apple, Inc.</i> , 2011 WL 588209 (N.D. Cal. Feb. 10, 2011) .....	16
<i>Bell Atl. Corp. v. Twombly</i> , 550 U.S. 544 (2007).....	20
<i>Benedek v. PLC Santa Monica, LLC</i> , 104 Cal. App. 4th 1351 (2002) .....	21
<i>Bennett v. U.S. Cycling Fed'n</i> , 193 Cal. App. 3d 1485 (1987).....	21
<i>Benson v. JPMorgan Chase Bank, N.A.</i> , 2010 WL 1526394 (N.D. Cal. April 15, 2010) .....	15
<i>Bily v. Arthur Young &amp; Co.</i> , 3 Cal. 4th 370 (1992) .....	22
<i>Calderon v. Total Wealth Mgmt., Inc.</i> , 2016 WL 898823 (S.D. Cal. Mar. 9, 2016) .....	19
<i>Casey v. U.S. Bank Nat'l Ass'n</i> , 127 Cal. App. 4th 1138 (2005) .....	<i>passim</i>
<i>Chance World Trading E.C. v. Heritage Bank of Commerce</i> , 438 F. Supp. 2d 1081 (N.D. Cal. 2005) .....	12
<i>Chazen v. Centennial Bank</i> , 61 Cal. App. 4th 532 (1998) .....	23

1	<i>Daniels-Hall v. Nat'l Educ. Ass'n</i> , 629 F.3d 992 (9th Cir. 2010).....	7, 8
2		
3	<i>Darnaa, LLC v. Google, Inc.</i> , 2015 WL 7753406 (N.D. Cal. Dec. 2, 2015).....	22
4		
5	<i>Diamond Multimedia Sys., Inc. v. Super. Ct.</i> , 19 Cal. 4th 1036 (1999) .....	18
6		
7	<i>In re Ditech Networks, Inc. Derivative Litig.</i> , 2008 WL 820705 (N.D. Cal. Mar. 26, 2008).....	17
8		
9	<i>Emery v. Visa Int'l Servs. Ass'n</i> , 95 Cal. App. 4th 952 (2002) .....	7, 13
10		
11	<i>ExxonMobil Oil Corp. v. Nicoletti Oil, Inc.</i> , 713 F. Supp. 2d 1105 (E.D. Cal. 2010).....	25
12		
13	<i>Ferrell v. S. Nev. Off-Road Enthusiasts, Ltd.</i> , 147 Cal. App. 3d 309 (1983).....	21
14		
15	<i>Ghlachi v. U.S. Bank, N.A.</i> , 2015 WL 12655411 (C.D. Cal. Apr. 29, 2015) .....	23
16		
17	<i>Grappo v. McMills</i> , 11 Cal. App. 5th 996 (2017) .....	25
18		
19	<i>Howard v. Super. Ct.</i> , 2 Cal. App. 4th 745 (1992) .....	9, 14
20		
21	<i>Janney v. Mills</i> , 944 F. Supp. 2d 806 (N.D. Cal. 2013) .....	16
22		
23	<i>Jimenez v. 24 Hour Fitness USA, Inc.</i> , 237 Cal. App. 4th 546 (2015) .....	25
24		
25	<i>Kainos Labs., Inc. v. Beacon Diagnostics, Inc.</i> , 1998 WL 2016634 (N.D. Cal. Sept. 14, 1998) .....	18, 20
26		
27	<i>Kearns v. Ford Motor Co.</i> , 567 F.3d 1120 (9th Cir. 2009).....	7, 16
28		
24	<i>Kesner v. Super. Ct.</i> , 1 Cal. 5th 1132 (2016) .....	24
25		
26	<i>Lazar v. Super. Ct.</i> , 12 Cal. 4th 631 (1996) .....	16
27		
28	<i>Litson-Gruenber v. JP Morgan Chase &amp; Co.</i> , 2009 U.S. Dist. LEXIS 117749 (N.D. Tex. Dec. 16, 2009) .....	10, 11

1	<i>McFall v. Stacy and Witbeck, Inc.</i> , 2016 WL 6248882 (N.D. Cal. Oct. 26, 2016).....	9, 10
2		
3	<i>McGraw Co. v. Aegis Gen. Ins. Agency, Inc.</i> , 2016 WL 3745063 (N.D. Cal. July 13, 2016).....	7
4		
5	<i>Mendelsohn v. Capital Underwriters, Inc.</i> , 490 F. Supp. 1069 (N.D. Cal. 1979) .....	15
6		
7	<i>Meram v. Citizens Title &amp; Trust, Inc.</i> , 2011 WL 11463 (S.D. Cal. Jan. 3, 2011).....	16
8		
9	<i>MTC Elec. Techs. Co. v. Leung</i> , 876 F. Supp. 1143 (C.D. Cal. 1995).....	18
10		
11	<i>Neilson v. Union Bank of Cal., N.A.</i> , 290 F. Supp. 2d 1101 (C.D. Cal. 2003) .....	14
12		
13	<i>Paralift, Inc. v. Super. Ct.</i> , 23 Cal. App. 4th 748 (1993) .....	21
14		
15	<i>Paz v. State</i> , 22 Cal. 4th 550 (2000) .....	22
16		
17	<i>Ray v. BlueHippo Funding, LLC</i> , 2008 WL 1995113 (N.D. Cal. May 6, 2008) .....	14
18		
19	<i>Rosner v. Bank of China</i> , 528 F. Supp. 2d 419 (S.D.N.Y. 2007).....	12, 15
20		
21	<i>Rowland v. Christian</i> , 69 Cal. 2d 108 (1968) .....	22, 23
22		
23	<i>S.F. Unified Sch. Dist. v. W.R. Grace &amp; Co.</i> , 37 Cal. App. 4th 1318 (1995) .....	24
24		
25	<i>Schaffer Family Investors, LLC v. Sonnier</i> , 120 F. Supp. 3d 1028 (C.D. Cal. 2015) .....	20
26		
27	<i>In re Sharp Int'l Corp.</i> , 281 B.R. 506 (Bankr. E.D.N.Y. 2002).....	13
28		
29	<i>Siegal v. Gamble</i> , 2016 WL 1085787 (N.D. Cal. Mar. 21, 2016).....	17
30		
31	<i>Software Design &amp; Application v. Hoefer &amp; Arnett</i> , 49 Cal. App. 4th 472 (1996) .....	24
32		
33	<i>In re Sony Gaming Networks &amp; Customer Data Sec. Breach Litig.</i> , 996 F. Supp. 2d 942 (S.D. Cal. 2014) .....	25
34		

1	<i>Spencer v. DHI Mortg. Co.,</i> 642 F. Supp. 2d 1153 (E.D. Cal. 2009).....	24
2		
3	<i>Wallack v. Idexx Labs., Inc.,</i> 2013 WL 5206190 (S.D. Cal. Sept. 12, 2013) .....	19
4		
5	<b>Rules and Statutes</b>	
6	Fed. R. Civ. Proc.	
7	Rule 8(a).....	16, 20
8	Rule 9(b) .....	<i>passim</i>
9	Rule 12(b)(6).....	7
10	Cal. Corp. Code	
11	§ 25008(a)-(b) .....	19
12	§ 25401.....	2, 18, 19, 20
13	§ 25504.1.....	<i>passim</i>
14		
15		
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## **MEMORANDUM OF POINTS AND AUTHORITIES**

## **INTRODUCTION**

3 This lawsuit is an opportunistic attempt to hold PayPal<sup>1</sup> liable for harm allegedly caused  
4 by others who are not—and currently cannot be made—parties to this case. Despite the fact that  
5 Plaintiffs expressly agreed and acknowledged by signing up for PayPal’s services that PayPal is  
6 only a “custodian” of funds that does “not have control of or liability for the products or services  
7 that are paid for with [PayPal’s] Services,” the Complaint is premised on the assertion that  
8 Plaintiffs are victims of a Ponzi/Pyramid scheme operated by Charles David Scoville (“Scoville”)  
9 and Traffic Monsoon, LLC (“Traffic Monsoon”), and that PayPal, as Traffic Monsoon’s primary  
10 payment service provider, is liable for Plaintiffs’ alleged losses.

11 Traffic Monsoon and Scoville are currently embroiled in litigation with the Securities and  
12 Exchange Commission (“SEC”) in the District of Utah, and that court has appointed a Receiver  
13 over both Traffic Monsoon and Scoville’s assets in order to recover alleged losses for Traffic  
14 Monsoon’s customers—including Plaintiffs. That court has also stayed litigation against Traffic  
15 Monsoon and Scoville. Despite the pendency of the Utah proceeding, Plaintiffs seek recovery  
16 from PayPal. As explained below, however, Plaintiffs’ Complaint fails to state any viable claim  
17 against PayPal.

18 Plaintiffs’ aiding and abetting claims must be dismissed because they fail to allege that  
19 PayPal “actually knew” that Scoville was operating Traffic Monsoon as a Ponzi scheme,  
20 defrauding his customers, or breaching fiduciary duties that he allegedly owed to purchasers of  
21 Traffic Monsoon’s advertising products. Indeed, the question of whether Traffic Monsoon’s  
22 business model even constitutes a Ponzi scheme is unsettled, and has been certified for  
23 interlocutory appeal to the Tenth Circuit. Regardless of the nature of Traffic Monsoon’s  
24 business, it is undisputed that PayPal unilaterally limited its account and froze the funds therein.  
25 Plaintiffs also allege that after the limitation was established, PayPal set up a hotline for  
26 concerned customers of Traffic Monsoon, and thereafter told some individuals that Traffic  
27 Monsoon was a scam. Such conduct underscores the implausibility of the notion that PayPal

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<sup>28</sup> <sup>1</sup> Defendants PayPal, Inc. and PayPal Holdings, Inc. are referred to collectively as “PayPal.”

1 knowingly and intentionally aided and abetted Traffic Monsoon and Scoville's alleged fraud or  
2 breach of fiduciary duty. At most, Plaintiffs' allegations show that PayPal had reason to suspect  
3 Traffic Monsoon. Putting aside the fact that PayPal acted upon those suspicions to prevent  
4 Scoville and Traffic Monsoon from processing further payments using its service, rather than aid  
5 and abet their alleged scheme, it is well-settled that allegations of "suspicion" do not satisfy the  
6 actual knowledge standard for alleging aiding and abetting claims.

7 Plaintiffs' attempt to allege the "intentional and substantial assistance" element of their  
8 aiding and abetting claims fares no better. The heft of Plaintiffs' allegations is that PayPal, a  
9 payment processor, processed a significant number of payments for Traffic Monsoon. This  
10 activity, which falls well within the "ordinary business transactions" of PayPal, cannot amount to  
11 substantial assistance under California law in the absence of allegations that PayPal intended to  
12 help the primary offender commit a specific fraud. Plaintiffs do not – and cannot – allege such  
13 critical facts. Put simply, there is nothing tortious about processing payments for Traffic  
14 Monsoon in the same manner PayPal processes payments for any other merchant. Nor is there  
15 anything wrong with PayPal charging fees to its customers. Far from "cloak[ing] Traffic  
16 Monsoon with an air of legitimacy," Plaintiffs themselves allege that PayPal took actions that are  
17 inconsistent with any intent to assist Traffic Monsoon—limiting Traffic Monsoon's PayPal  
18 account and setting up a customer service line for individuals who were concerned about Traffic  
19 Monsoon. Try as they might, Plaintiffs cannot concoct an aiding and abetting claim out of the  
20 mere fact that PayPal, for a time, did business with Traffic Monsoon and its customers.

21 Plaintiffs' claim under California Corporations Code section 25504.1 is equally flawed.  
22 Plaintiffs predicate this claim upon Traffic Monsoon's alleged violation of California  
23 Corporations Code section 25401, which prohibits the purchase or sale (or offers to purchase or  
24 sell) securities in the state of California by means of material misrepresentations or omissions.  
25 But Plaintiffs fail to plead the purchase or sale of Traffic Monsoon's products in the state of  
26 California, even assuming that they constitute securities under California law. Nor can they do  
27 so—Plaintiffs and the proposed class are all non-U.S. residents, and Traffic Monsoon is a Utah-  
28 based LLC that promoted and sold its products from Utah. Even putting aside that core

1 jurisdictional defect, Plaintiffs' claim would still fail because they do not come close to alleging  
2 facts establishing that PayPal (i) materially assisted Traffic Monsoon and Scoville in selling  
3 securities by means of false or misleading statements, and (ii) intended to defraud Plaintiffs.

4 Plaintiffs' claim for negligence fails because they contractually disclaimed any negligence  
5 claim against PayPal resulting from the direct or indirect actions of third parties like Traffic  
6 Monsoon and Scoville, and agreed and acknowledged that PayPal is only a "custodian" of funds  
7 that does "not have control of or liability for the products or services that are paid for with  
8 [PayPal's] Services." Even if Plaintiffs had not disclaimed any negligence claim against PayPal  
9 vis-à-vis third parties, they fail to allege facts establishing that PayPal owed them a legal duty of  
10 care to protect them from Traffic Monsoon and Scoville. Moreover, Plaintiffs seek only  
11 economic damages from PayPal, and purely economic damages are unavailable in a negligence  
12 claim absent a showing of a "special relationship" among the parties. No such special  
13 relationship is alleged or exists between Plaintiffs and PayPal.

14 Lastly, Plaintiffs' claim for gross negligence must be dismissed because it is well-settled  
15 that there is no recognized cause of action for gross negligence under California law.

16 **FACTUAL BACKGROUND<sup>2</sup>**

17 **I. PayPal And Its Business**

18 PayPal is a leading technology platform company that enables digital and mobile  
19 payments on behalf of customers and merchants worldwide. Compl. ¶ 78. Through its various  
20 payment solution products, PayPal enables customers and merchants to connect and transact in  
21 new and powerful ways, with access to money anytime and through various platforms and  
22 devices. *Id.* ¶ 88. Through a combination of technological innovation, PayPal creates better  
23 ways to manage and move money, offers choice and flexibility when sending payments, and  
24 provides safer and simpler ways for businesses of various sizes to accept payments. *Id.* ¶¶ 82-89.  
25 PayPal also employs a variety of account and review monitoring procedures, which are conducted  
26 for a variety of reasons including the detection of high-risk accounts and accounts engaged in  
27 fraudulent activity. Compl. ¶¶ 82-83, 88.

28 <sup>2</sup> All "Ex. \_\_" references are to the exhibits attached to Defendants' Request for Judicial Notice.

1        **II. Traffic Monsoon and Charles Scoville**

2        In or around October 2014, Scoville created Traffic Monsoon, a limited liability company  
3        based in Utah that represented itself as a “pay-to-click” advertising and revenue sharing company.  
4        *Id.* ¶¶ 36-37. Traffic Monsoon’s website touted its mission to “provide high quality ad services  
5        for affordable prices, and share revenues for a perfect winning combination that will lead to the  
6        ultimate success of our customers.” Ex. 5 ¶ 3. Marketing itself as a successful Internet  
7        advertising services company, Traffic Monsoon offered seven different products for purchase to  
8        deliver visits, or “clicks,” to customers’ websites to make the websites appear more popular and  
9        to improve search engine results. *Id.* ¶ 4; Compl. ¶¶ 38-39. One such product was known as the  
10       “Banner AdPack” (“AdPack”). Compl. ¶ 39. Priced at \$50 each, AdPacks provided purchasers  
11       with 1,000 unique visits to their website, twenty clicks on the purchaser’s banner ads, and the  
12       opportunity to share in Traffic Monsoon’s revenues. *Id.* In order to share in the company’s  
13       revenues, an AdPack purchaser was required to affirmatively click on a certain number of banner  
14       ads per day. *Id.* ¶ 43. Once an AdPack earned \$55, the purchaser could withdraw that money or  
15       buy a new AdPack. *Id.* ¶¶ 41, 44. Traffic Monsoon’s website stated there was no set timeframe  
16       for the purchaser’s AdPack to reach \$55, nor offered any assurance that it would ever in fact  
17       reach \$55. Ex. 5 ¶ 24.

18        **III. PayPal Unilaterally Limits Traffic Monsoon’s PayPal Account**

19        In or around September 2014, Scoville opened a PayPal account for Traffic Monsoon (the  
20       “Account”). Compl. ¶ 129. Traffic Monsoon, like other PayPal merchants, used PayPal to  
21       process payments to and from Traffic Monsoon. *Id.* ¶ 3. Between September 2014 and early  
22       2016, the Account experienced significant growth and a relatively low amount of chargebacks.  
23       *Id.* ¶ 139. On January 11, 2016, PayPal informed Scoville that it had placed a limitation on the  
24       Account based on its reviews of the Account and its concerns about potential risks associated  
25       with the growth of Traffic Monsoon. *Id.* ¶¶ 144-146. On January 12, 2016, Scoville posted a  
26       YouTube video for current and prospective purchasers of the AdPacks, stating that he was  
27       transitioning away from PayPal. Scoville failed to disclose PayPal’s limitation of the Account.  
28       Ex. 5 ¶ 48. Scoville then moved Traffic Monsoon’s payment processing activity to JPMorgan

1 Chase and other payment processors including Payza, Allied Wallet, and SolidTrustPay. Ex. 3 at  
2 3, 7. PayPal further limited the Account on February 11, 2016, at which time it held  
3 approximately \$60 million in frozen funds. Ex. 7 ¶ 37; Compl. ¶ 150. As alleged in the  
4 Complaint, after imposing the limitation, PayPal established a telephone number through which  
5 Traffic Monsoon customers could “address concerns” about Traffic Monsoon. Compl. ¶ 147.

6 **IV. The SEC Files Suit Against Traffic Monsoon And Scoville**

7 After PayPal unilaterally limited the Account in early 2016, on July 26, 2016, the SEC  
8 filed suit against Traffic Monsoon and Scoville in the U.S. District Court for the District of Utah  
9 (the “SEC Action”). Ex. 1. The SEC alleged that AdPacks were unregistered investment  
10 contracts, and Traffic Monsoon’s sale of AdPacks constituted an illegal Ponzi scheme that  
11 violated Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10(b)-(5), among  
12 others. Ex. 1. The same day, the SEC filed an ex parte application for a temporary restraining  
13 order preventing Scoville’s withdrawal of funds from the Account, which was granted the same  
14 day. Exs. 2-3. On July 27, 2016, the Utah Court appointed a receiver to gather and manage  
15 Scoville’s and Traffic Monsoon’s assets during the pendency of the SEC Action. Ex. 4.  
16 Consistent with the Utah Court’s orders, PayPal froze and transferred possession and control of  
17 all funds remaining in the Account to the receiver, and assisted the receiver in gaining access to  
18 the Account. Exs. 3-4.

19 On March 28, 2017, the Utah Court granted the SEC’s request for preliminary injunction  
20 prohibiting Scoville and Traffic Monsoon from conducting business and freezing all of their  
21 assets. Exs. 7-8. Through its preliminary injunction order, the Utah Court took “exclusive  
22 jurisdiction and possession of the assets, of whatever kind and wherever situated,” of Traffic  
23 Monsoon and Scoville “that were obtained directly or indirectly from Traffic Monsoon,” and  
24 froze those assets “until further order.” Ex. 8 at 2. The Utah Court further ordered “a stay of all  
25 litigation in any court against” Traffic Monsoon or Scoville where the SEC is not a party in the  
26 lawsuit and the lawsuit “involves” the frozen assets, enjoined the parties to any such litigation  
27 “from taking any action in connection with the lawsuit, including, but not limited to, the issuance  
28

1 or employment of process,” and enjoined any courts presiding over such litigation “from taking or  
2 permitting any action in the lawsuit until further order.” *Id.* at 3.

3 **V. The Certified Interlocutory Appeal Before The Tenth Circuit**

4 Acknowledging that “Traffic Monsoon’s sale of AdPacks differ[ed] somewhat from the  
5 run-of-the-mill Ponzi scheme,” the Utah Court certified for interlocutory appeal the issue of  
6 whether “Traffic Monsoon’s particular business model constituted a Ponzi scheme in light of the  
7 contingent nature of the promised returns,” as the issue was one of first impression in the circuit.  
8 Ex. 7 at 38-39, 44. Indeed, Scoville and Traffic Monsoon assert that Traffic Monsoon operated a  
9 legitimate Internet advertising business, not a Ponzi scheme, because it did not promise any  
10 particular rate of return for purchases and specifically notified customers that reaching the  
11 maximum payout was not guaranteed. *See generally* Ex. 7. The appeal is still pending.

12 **VI. Unable To Sue Traffic Monsoon Or Scoville, Plaintiffs Sue PayPal Instead**

13 On May 4, 2017, Plaintiffs—both residents of Alberta, Canada<sup>3</sup>—brought the instant suit  
14 against PayPal alleging claims of: (i) aiding and abetting fraud; (ii) aiding and abetting breach of  
15 fiduciary duty; (iii) negligence; (iv) gross negligence; and (v) violation of Section 25504.1.  
16 Plaintiffs contend that through its sale of AdPacks, Traffic Monsoon perpetrated an illegal and  
17 fraudulent Ponzi scheme. Compl. ¶¶ 36-77. They allege that, in order to profit from substantial  
18 fees, PayPal knowingly and intentionally aided and abetted Traffic Monsoon’s alleged Ponzi  
19 scheme by allowing the company to open and maintain a PayPal account through which Traffic  
20 Monsoon’s customers deposited payments for AdPacks. *Id.* ¶¶ 102-120, 129-143. To support  
21 these claims, Plaintiffs highlight, among other things: (i) PayPal’s decisions to place limitations  
22 on the Account; (ii) PayPal’s establishment of a telephone number through which Traffic  
23 Monsoon customers could “address concerns” about Traffic Monsoon; and (iii) alleged  
24 statements made by PayPal to Traffic Monsoon customers after the limitation was in place that  
25 the Account was a “scam.” *Id.* ¶¶ 144-150.

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<sup>3</sup> According to filings in the Utah Action, approximately 90%, or 145,000, of Traffic Monsoon’s  
AdPack purchasers reside outside the United States. Ex. 1 ¶ 66.

## **ARGUMENT<sup>4</sup>**

**I. Plaintiffs Fail To Plead With Particularity That PayPal Aided And Abetted Traffic Monsoon And Scoville's Alleged Fraud**

In their first claim, Plaintiffs allege that PayPal aided and abetted Traffic Monsoon and Scoville in committing fraud. Compl. ¶¶ 172-185. According to the Complaint, Traffic Monsoon and Scoville “knowingly defrauded investors because Traffic Monsoon was a Ponzi/pyramid scheme”; “[o]n its website, Traffic Monsoon, through Scoville, [] knowingly misrepresented to AdPack investors that they were purchasing advertising services with the opportunity to share in revenues that Traffic Monsoon received from its advertising business, that their purchases were not investments and that Traffic Monsoon was not a Ponzi/pyramid scheme”; and Scoville “omitted to disclose to AdPack investors that they were purchasing investments, that he was paying existing Traffic Monsoon investors with new Traffic Monsoon investor money, and that Traffic Monsoon was a Ponzi/pyramid scheme.” *Id.* ¶¶ 172, 173.

To state claim for aiding and abetting fraud, Plaintiffs must allege facts showing that PayPal (1) had “actual knowledge” of the alleged fraud “in which [it] purportedly participated,” and (2) “intentionally [and substantially] assisted” Traffic Monsoon and Scoville to commit the violation. *Casey v. U.S. Bank Nat'l Ass'n*, 127 Cal. App. 4th 1138, 1144, 1148 (2005); *Emery v. Visa Int'l Servs. Ass'n*, 95 Cal. App. 4th 952, 959 (2002). Claims for aiding and abetting fraud are subject to Rule 9(b)’s heightened pleading requirements. *See McGraw Co. v. Aegis Gen. Ins. Agency, Inc.*, 2016 WL 3745063, at \*6 (N.D. Cal. July 13, 2016).

Plaintiffs' claim for aiding and abetting fraud must be dismissed because Plaintiffs do not allege facts showing that PayPal had actual knowledge of the alleged fraud or that it intentionally

<sup>4</sup> To survive a Rule 12(b)(6) motion to dismiss, “a complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citation omitted). The Court, however, need not accept as true allegations that contradict documents referred to in the complaint or matters subject to judicial notice, or allegations that are conclusory, unwarranted deductions of fact, or unreasonable inferences. *Daniels-Hall v. Nat’l Educ. Ass’n*, 629 F.3d 992, 998 (9th Cir. 2010). In addition, claims that “sound in fraud” or are predicated on misrepresentation are subject to the heightened pleading standard of Rule 9(b), which requires plaintiffs to allege the “who, what, when, where, and how of the misconduct charged.” *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1124 (9th Cir. 2009) (citation omitted). “Any averments which do not meet that standard should be ‘disregarded,’ or ‘stripped’ from the claim for failure to satisfy Rule 9(b).” *Id.*

1 and substantially assisted Scoville and Traffic Monsoon to commit fraud. Far from it, Plaintiffs' 2 allegations show that PayPal acted pursuant to its stated policies to investigate and limit accounts 3 it has reason to believe may violate the terms of PayPal's User Agreement or otherwise present a 4 high level of risk. *See* Compl. ¶¶ 144-45; Ex. 14 § 10.6 "Actions by PayPal – Account Closure, 5 Termination of Service, Limited Account Access; Confidential Criteria."

6 In addition to the Complaint's failure to plead the elements of aiding and abetting with 7 particularity under Rule 9(b), Plaintiffs' claims that PayPal was somehow "in" on Traffic 8 Monsoon and Scoville's alleged frauds are not plausible in light of PayPal's investigation and 9 limitation of the Account. *See* Compl. ¶¶ 144-150. Plaintiffs' own allegations establish that 10 PayPal's actions were intended to, and did, hinder Scoville's operation of Traffic Monsoon—a 11 fact that is evident by his switch from PayPal to other payment processors. Ex. 7 ¶ 34. Because 12 Plaintiffs have not pleaded a claim that is plausible on its face, it must be dismissed. *Iqbal*, 556 13 U.S. at 678. Finally, Plaintiffs' aiding and abetting claim must be dismissed because they fail to 14 allege the underlying alleged fraud with the requisite particularity pursuant to Rule 9(b), as they 15 must.

16 **A. Plaintiffs' Aiding And Abetting Claim Is Implausible**

17 A claim warrants dismissal when a plaintiff's allegations give rise to implausible or 18 unreasonable inferences. *See Iqbal*, 556 U.S. at 678; *Daniels-Hall*, 629 F.3d at 998. Determining 19 whether a plaintiff states a plausible claim is a context-specific task that requires a trial court to 20 draw on "its judicial experience and common sense." *Iqbal*, 556 U.S. at 679.

21 Here, according to Plaintiffs' own allegations, PayPal investigated and ultimately limited 22 Traffic Monsoon's account, subsequently created a hotline for concerned Traffic Monsoon 23 customers, and then told some of them that the account was a scam. Compl. ¶¶ 144-150. These 24 allegations are irreconcilable with the notion that PayPal had actual knowledge of the alleged 25 fraud and intentionally and substantially assisted Scoville and Traffic Monsoon to commit the 26 fraud. It simply defies logic that PayPal would knowingly and intentionally act in concert with 27 Traffic Monsoon and Scoville to defraud purchasers of AdPacks, and then take steps to expose 28 and prevent its own fraud. Plaintiffs' aiding and abetting fraud claim should be dismissed for that

1 reason alone. *See, e.g., Adam v. Silicon Valley Bancshares*, 1994 WL 619300, at \*4 (N.D. Cal.  
2 Feb. 8, 1994) (“inferences that people acted in an economically irrational manner should not be  
3 indulged in without some explanation”).

4 **B. Plaintiffs Fail To Adequately Plead That PayPal Had Actual Knowledge Of  
5 Traffic Monsoon And Scoville’s Alleged Fraud**

6 Under well-settled law, a plaintiff cannot plead “actual knowledge” for purposes of aiding  
7 and abetting based on “suspicion and surmise,” *Casey*, 127 Cal. App. 4th at 1147, or generalized  
8 knowledge of “wrongful or illegal conduct.” *McFall v. Stacy and Witbeck, Inc.*, 2016 WL  
9 6248882, at \*5 (N.D. Cal. Oct. 26, 2016). Rather, to establish actual knowledge, the plaintiff  
10 must allege facts showing that the defendant “reach[ed] a conscious decision to participate in  
11 tortious activity for the purpose of assisting another” to perform a specific wrongful act. *Howard  
12 v. Super. Ct.*, 2 Cal. App. 4th 745, 749 (1992). In other words, “[a] defendant can be held liable  
13 as a cotortfeasor on the basis of acting in concert only if he or she knew that a tort had been, or  
14 was to be, committed, and acted *with the intent of facilitating the commission of that [specific]  
15 tort.*” *Casey*, 127 Cal. App. 4th at 1146 (citation omitted).

16 Plaintiffs assert that PayPal actually knew the supposed truth that Scoville operated  
17 Traffic Monsoon as a Ponzi scheme and that he fraudulently marketed interests in the scheme as  
18 “advertising services” rather than investments (Compl. ¶ 173) based on various factors, including  
19 that: (1) PayPal previously banned other pay-to-click businesses operated by Scoville following  
20 allegations that they were Ponzi schemes; (2) the Account experienced a high percentage of  
21 growth relative to the percentage of chargebacks, and exhibited other activity that is purportedly  
22 indicative of a Ponzi scheme; and (3) Traffic Monsoon’s website stated that it sold advertising  
23 services with “revenue sharing positions,” whereas Scoville represented to PayPal that it offered  
24 investments.<sup>5</sup> *Id.* ¶¶ 11, 13-15, 145-47, 179.

25  
26 <sup>5</sup> Plaintiffs also allege that sometime after PayPal limited the Account, it set up a telephone  
27 number for customers to call to address concerns regarding Traffic Monsoon, and thereafter told  
28 some customers that Traffic Monsoon was a scam. Compl. ¶¶ 147-48. Even if these statements  
indicate that PayPal ultimately suspected Traffic Monsoon to be a scam, they underscore the  
implausibility of Plaintiffs’ theory that PayPal *intended to assist* Scoville to hide Traffic  
Monsoon’s true nature from its customers.

1           None of these factors are sufficient to show that PayPal had actual knowledge of the  
2 specific alleged fraudulent conduct by Scoville and Traffic Monsoon. At most, Plaintiffs'  
3 allegations can only establish that PayPal should have suspected or knew “*something* fishy was  
4 going on with the account[],” *Casey*, 127 Cal. App. 4th at 1149—which ultimately caused PayPal  
5 to investigate the Account, limit the Account and take measures to address impacted Traffic  
6 Monsoon customers. *See Compl.* ¶¶ 21, 23, 147. That is not sufficient to state a claim for aiding  
7 and abetting fraud. *See McFall*, 2016 WL 6248882, at \*6 (“It is not enough to say that Houlahan  
8 should have known that ‘something fishy’ was going on”); *see also Casey*, 127 Cal. App. 4th at  
9 1149 (suspicion of wrongdoing and investigation into the same does not establish actual  
10 knowledge).

11           **1.       Knowledge That Traffic Monsoon Was A Pay-To-Click Business**  
12           **Operated By Scoville Cannot Establish Actual Knowledge That**  
13           **Traffic Monsoon Was A Ponzi Scheme**

14           Plaintiffs’ allegations that PayPal knew it had previously banned “similar pay-to-click  
15 businesses” operated by Scoville do not establish that PayPal knew Traffic Monsoon was a Ponzi  
16 scheme or that Scoville was misrepresenting the nature of Traffic Monsoon to his customers. As  
17 to Scoville’s prior accounts, Plaintiffs provide no particularized facts that these “similar”  
18 businesses were in fact Ponzi schemes, or that PayPal knew them to be such. Similarly, there are  
no allegations that PayPal knew that Traffic Monsoon’s business was a Ponzi scheme.

19           Even if Plaintiffs did allege that PayPal knew Scoville’s prior businesses operated  
20 fraudulently (they have not), that still could not establish PayPal’s actual knowledge of the  
21 underlying fraud alleged in this case. Actual knowledge of a third-party’s previous wrongdoing,  
22 *or even conviction of securities crimes*, does not establish actual knowledge that the third-party  
23 later perpetrated a specific tort. *See Litson-Gruenber v. JP Morgan Chase & Co.*, 2009 U.S. Dist.  
24 LEXIS 117749 (N.D. Tex. Dec. 16, 2009). In *Litson-Gruenber*, a Ponzi scheme victim sued JP  
25 Morgan Chase for aiding and abetting the Ponzi defendants’ breach of fiduciary duties and fraud,  
26 alleging that JP Morgan Chase’s predecessor in interest permitted the Ponzi defendants to open an  
27 account despite knowing that they had been convicted of securities laws violations in multiple  
28 states, and permitted more than \$100 million to be deposited into the account. *See Ex. 16* ¶¶ 19,

1 23, 29. Nevertheless, the court held that plaintiff failed to allege actual knowledge that the Ponzi  
2 defendants were making misrepresentations to the investors or stealing their money via a Ponzi  
3 scheme, and was “at best, merely a story of suspicious activity.” *Litson-Gruenber*, 2009 U.S.  
4 Dist. LEXIS 117749, at \*8. Similar to *Litson-Gruenber*, Plaintiffs’ allegations that Scoville was  
5 previously accused of operating businesses engaged in fraudulent activity cannot establish  
6 PayPal’s knowledge of Scoville’s allegedly fraudulent operation of Traffic Monsoon.

7 Finally, Plaintiffs cannot allege facts showing that PayPal actually knew that Traffic  
8 Monsoon’s particular business model constituted a Ponzi scheme because even now, it is  
9 unsettled as a matter of law whether in fact Traffic Monsoon operated as a Ponzi scheme. The  
10 only court to have considered the issue is the U.S. District Court for the District of Utah in the  
11 SEC Action, and that court certified the issue for interlocutory appeal to the Tenth Circuit. As the  
12 Utah Court recognized, Traffic Monsoon had “unique aspects” that “differentiate[d] it from other  
13 Ponzi schemes.” Ex. 7 at 35 n.15. Among Traffic Monsoon’s key differentiating features was  
14 that, unlike typical Ponzi schemes which promise high rates of return, Scoville represented to all  
15 AdPack purchasers that receiving any return was contingent on the profitability of Traffic  
16 Monsoon. *Id.* at 35-37. The Utah Court concluded that whether “Traffic Monsoon’s particular  
17 business model constitutes a Ponzi scheme in light of the contingent nature of the promised  
18 returns” was a “question of law as to which there is substantial ground for difference of opinion.”  
19 *Id.* at 44. A district court is significantly better suited than PayPal to determine whether a  
20 business’s particular characteristics qualifies it as a Ponzi scheme, and yet it recognized that the  
21 determination is not a clear cut one. This further undermines the notion that PayPal had “actual  
22 knowledge” that Scoville and Traffic Monsoon were operating a Ponzi scheme. Plaintiffs have  
23 not, nor can they, plead facts that would establish that PayPal knew that Scoville and Traffic  
24 Monsoon were operating a Ponzi scheme, where a court with far more information available to it  
25 to inform the issue expressed equivocation around the ultimate legal conclusion.

26 **2. Knowledge Of Unusual Account Activity Cannot Establish Actual  
27 Knowledge That Traffic Monsoon Was A Ponzi Scheme**

28 Plaintiffs’ allegations related to Traffic Monsoon’s supposedly unusual account activity,

1 including that the Account contained commingled funds, experienced rapid growth, and had few  
2 chargebacks (Compl. ¶¶ 139, 179), also fail to establish actual knowledge of an underlying fraud.  
3 Knowledge of unusual account activity does not establish knowledge that the Account was used  
4 to perpetrate a specific offense.

5 For example, in *Casey*, a bankruptcy trustee sued several banks for aiding and abetting a  
6 scheme perpetrated by the debtor corporation’s fiduciaries to divert \$36 million in investor funds.  
7 127 Cal. App. 4th at 1141, 1149. The trustee alleged the banks knew about the fraudulent scheme  
8 because they knew that the fiduciaries used invalid tax identification numbers to open numerous  
9 bank accounts, which were used to funnel \$6 million in cash in unmarked duffel bags from the  
10 banks’ vaults to their personal bank accounts in violation of banking regulations, monetary  
11 restrictions on the face of checks, and the banks’ own internal policies and procedures. *Id.* at  
12 1142, 1149. But these allegations of “suspicious account activities—even money laundering” did  
13 not amount to actual knowledge—*i.e.*, that the banks knew that the “[f]iduciaries were stealing  
14 corporate funds” in breach of their fiduciary duties. *Id.* at 1151. Here, Plaintiffs’ claims are  
15 much less compelling than the legally deficient claims in *Casey*. Other than stating their  
16 conclusion that the Account operated as a Ponzi scheme in violation of PayPal’s Acceptable Use  
17 Policy (see Compl. ¶¶ 13, 180), Plaintiffs have not alleged any facts comparable to the facts  
18 alleged in *Casey* that suggest PayPal knew that particular Account transactions violated PayPal’s  
19 policies or procedures.

20 Other courts have likewise refused to infer actual knowledge of a specific underlying  
21 offense from knowledge of account activity that, in hindsight, could have raised suspicions of an  
22 improper use of the account. *See, e.g., Chance World Trading E.C. v. Heritage Bank of*  
23 *Commerce*, 438 F. Supp. 2d 1081, 1085 (N.D. Cal. 2005) (“Even if the transfers out of [the  
24 checking account] did not comport with Heritage Bank rules or California corporate law, that  
25 alone is insufficient to show that Heritage Bank was aware of [the primary tortfeasor’s] misuse of  
26 funds.”); *Rosner v. Bank of China*, 528 F. Supp. 2d 419, 426 (S.D.N.Y. 2007) (bank’s alleged  
27 knowledge that account transactions were “inconsistent with [the underlying defendant’s] alleged  
28 business” did not establish actual knowledge of an underlying fraud); *In re Sharp Int’l Corp.*, 281

1 B.R. 506 (Bankr. E.D.N.Y. 2002) (lender's alleged knowledge that principals were fraudulently  
2 inflating the company's receivables was insufficient to plead actual knowledge of their diversion  
3 of company money). As in each of these cases, Plaintiffs' allegations that PayPal knew Traffic  
4 Monsoon's account activity could be consistent with Ponzi activity do not establish actual  
5 knowledge that Scoville was operating the account as a Ponzi scheme or misrepresenting the  
6 specific fraudulent nature of the business to his customers.

7 In any event, the claim that PayPal knowingly and intentionally assisted Scoville and  
8 Traffic Monsoon to commit fraud is also inconsistent with the allegations in the Complaint that  
9 PayPal's internal controls and anti-fraud detection procedures were inadequate to detect the risk  
10 posed by the Account. *See, e.g.*, Compl. ¶ 161 ("Such flagrant inadequacies and/or breakdowns  
11 in PayPal's internal controls and communications between various PayPal agents and/or  
12 departments played a key role in enabling the Traffic Monsoon scheme"). A breakdown in  
13 internal controls and failure to detect and prevent a fraud do not establish, and are logically  
14 inconsistent with, "actual knowledge" of the fraud. *See, e.g.*, *Emery*, 95 Cal. App. 4th at 963, 965  
15 (holding that plaintiffs failed to establish aiding and abetting where "[t]he worst that can be said  
16 is [the defendant] did not take more aggressive corrective steps" to prevent the target offense); *In*  
17 *re Agape Litig.*, 773 F. Supp. 2d 298, 320 (E.D.N.Y. 2011) (finding that bank's decision to shut  
18 down its High-Risk Compliance Group, while potentially "an unwise business decision," did not  
19 raise an inference that the bank "act[ed] with a culpable state of mind" for purposes of  
20 establishing actual knowledge).

21 **3. Knowledge That AdPacks Were Variously Called "Investments"  
22 And "Revenue Sharing Positions" Cannot Establish Actual  
Knowledge That Traffic Monsoon Was A Ponzi Scheme**

23 Plaintiffs allege that PayPal knew that Scoville supposedly misrepresented AdPacks as  
24 "advertising services" with "revenue sharing positions" when in reality they were "investments"  
25 because it "reviewed Traffic Monsoon's website and information provided by Scoville when  
26 Scoville applied for a merchant account for Traffic Monsoon." Compl. ¶¶ 37, 48, 179. However,  
27 as Plaintiffs acknowledge, Traffic Monsoon offered seven products for sale, only one of which  
28 Plaintiffs allege was an investment. *See id.* ¶ 39. At most, Plaintiffs have pleaded that PayPal

1 was aware of a potential discrepancy in how Scoville described just one of Traffic Monsoon’s  
2 products to PayPal and to his customers. Allegations of knowledge of inconsistent statements are  
3 not tantamount to actual knowledge of which (if any) of the statements is correct. *See In re*  
4 *Agape Litig.*, 773 F. Supp. 2d at 310-11 (allegations that a bank had actual knowledge of fraud  
5 because “the account activity . . . was inconsistent with [the underlying tortfeasor’s]  
6 representations” about the business’s operations “at most indicate only constructive knowledge of  
7 a fraudulent scheme”) (citation omitted).

8

9 **C. Plaintiffs Fail To Adequately Plead That PayPal Intentionally And  
Substantially Assisted Traffic Monsoon And Scoville’s Alleged Fraud**

10 Plaintiffs also fail to allege with particularity what PayPal supposedly did to “intentionally  
11 and substantially assist” Scoville to operate Traffic Monsoon as a Ponzi scheme. The allegation  
12 that PayPal “allowed Scoville to open an account for Traffic Monsoon and use its services,” even  
13 though it allegedly knew that Traffic Monsoon was a Ponzi scheme (Compl. ¶ 180), is hardly  
14 particularized. The allegation that PayPal “cloaked” Traffic Monsoon “with a false air of  
15 legitimacy” because Traffic Monsoon displayed PayPal’s name on its website and PayPal  
16 represents that it monitors accounts for fraud (*id.*), fares no better.<sup>6</sup> These two allegations merely  
17 show that PayPal operated in its usual manner as a payment processor, and are a far cry from  
18 properly pleading intentional or “substantial assistance” to a Ponzi scheme. *Casey*, 127 Cal. App.  
19 4th at 1145 (in California, “ordinary business transactions” do not amount to substantial  
20 assistance unless the defendant “actually knew those transactions were assisting the customer in  
21 committing a specific tort” and consciously decided to assist.); *Howard*, 2 Cal. App. 4th at 749.

22 Plaintiffs seek to bolster these allegations by claiming that PayPal sought to help Scoville  
23 operate a Ponzi scheme so it could earn a profit. Compl. ¶ 183. They allege that the size of

24 <sup>6</sup> PayPal’s alleged conduct fell far short of conduct that provides the primary tortfeasor “with a  
25 false air of legitimacy.” *Cf. Ray v. BlueHippo Funding, LLC*, 2008 WL 1995113, at \*4 (N.D. Cal.  
26 May 6, 2008) (finding defendant provided BlueHippo with an “aura of respectability” by putting  
27 a direct link to BlueHippo’s website on its website with an assurance that BlueHippo was an  
28 authorized reseller of its products); *Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d 1101,  
1132 (C.D. Cal. 2003) (finding that defendant “created a sense of security” in investors in a Ponzi  
scheme by representing that investor accounts were audited and by “covering for” the Ponzi  
defendant when he did not make payments on time and “calming potentially irate investors”).  
Plaintiffs do not allege anything akin to these allegations in their Complaint.

1 Traffic Monsoon’s account was a “radical departure from PayPal’s business as a payment  
2 processor.” *Id.* ¶ 180. But that allegation is nonsensical. PayPal is a large and sophisticated  
3 company that is equipped to handle small and large accounts. The assertion that PayPal “profited  
4 greatly from the Traffic Monsoon scheme” by earning transaction fees and interest (*id.* ¶ 17),  
5 alleges nothing more than a “generalized motive, one which could be imputed to any publicly-  
6 owned, for-profit endeavor.” *Rosner*, 528 F. Supp. 2d at 426 (citation omitted).

7 Plaintiffs finally allege that PayPal assisted Scoville to operate a Ponzi scheme by first  
8 suspending account withdrawals, but not deposits, and then temporarily lifting the freeze before  
9 the Utah Court froze the account.<sup>7</sup> Compl. ¶ 180. But the fact that PayPal took action against  
10 Scoville and Traffic Monsoon *undercuts*, rather than support, the inference that Plaintiffs ask the  
11 Court to make. Moreover, according to the Complaint, it was a breakdown in internal controls  
12 and anti-fraud detection systems that “enabled” the alleged Traffic Monsoon “scheme”—not an  
13 “intent” on PayPal’s part to assist the alleged scheme. *See id.* ¶¶ 158-161.

14 Moreover, as soon as PayPal limited Traffic Monsoon’s account, Scoville engaged  
15 JPMorgan Chase and other payment processors including Payza, Allied Wallet, and  
16 SolidTrustPay, to process payments for Traffic Monsoon. Ex. 7 ¶ 34 (“With the introduction of  
17 these new payment processors, AdPack transactions began to rise again.”). The ease at which  
18 Traffic Monsoon switched from PayPal to other payment processors demonstrates that PayPal  
19 was never a crucial component to Traffic Monsoon’s operation. Defendants whose services are  
20 easily replaced do not provide substantial assistance and cannot be found liable for aiding and  
21 abetting the underlying tort. *Compare Mendelsohn v. Capital Underwriters, Inc.*, 490 F. Supp.  
22 1069, 1084 (N.D. Cal. 1979) (plaintiff failed to allege substantial assistance because “had [the  
23 accountant] quit upon learning [of the underlying defendant’s] irregular financial practices, [the  
24 underlying defendant] could simply have hired a less astute accountant or bookkeeper”), *with*  
25 *Benson v. JPMorgan Chase Bank, N.A.*, 2010 WL 1526394, at \*5 (N.D. Cal. April 15, 2010)

26 <sup>7</sup> PayPal placed a 180 day hold on funds in the Account consistent with the terms of the User  
27 Agreement applicable to U.S. users such as Traffic Monsoon. *See Ex. 15* (PayPal U.S. User  
28 Agreement, “Actions We May Take If You Engage In Any Restricted Activities”). Such a hold,  
in line with the established terms of PayPal’s User Agreement, is not consistent with an intent to  
defraud.

1 (“The fact that Mr. Wise had tried at least three other U.S. banks, all of which declined his  
2 business apparently due to its suspicions nature, lends further support for the notion that  
3 WaMu/JPMorgan’s services played a critical part in the maintenance of the Ponzi scheme.”).

4 **D. Plaintiffs Fail To Plead The Alleged Underlying Fraud With Particularity**

5 Finally, Plaintiffs’ aiding and abetting fraud claim fails because they have not alleged  
6 specific facts showing that they actually relied on any alleged misrepresentation or omission by  
7 Traffic Monsoon or Scoville. *See Lazar v. Super. Ct.*, 12 Cal. 4th 631, 638 (1996) (actual  
8 reliance is an element of fraud). “[T]he mere assertion of ‘reliance’ is insufficient. The plaintiff  
9 must allege the specifics of his or her reliance on the misrepresentation to show a bona fide claim  
10 of actual reliance.” *Baltazar v. Apple, Inc.*, 2011 WL 588209, at \*3 (N.D. Cal. Feb. 10, 2011)  
11 (quoting *Cadlo v. Owens-Illinois, Inc.*, 125 Cal. App 4th 513, 519 (2004)).

12 Here, Plaintiffs merely assert in conclusory fashion that they “and members of the  
13 proposed Class relied to their detriment on Traffic Monsoon and Scoville’s misrepresentations  
14 and omissions when purchasing AdPacks.” Compl. ¶ 177. That boilerplate allegation would not  
15 suffice even under Rule 8(a), much less Rule 9(b). *See Iqbal*, 556 U.S. at 678. Nowhere in the  
16 Complaint do Plaintiffs identify the specific representations they purportedly relied upon or found  
17 material or allege when they actually reviewed those representations, if ever, as required by Rule  
18 9(b).<sup>8</sup> Plaintiffs’ failure to allege actual reliance, and hence the underlying fraud, with the  
19 requisite particularity, requires dismissal of their derivative claim for aiding and abetting fraud.  
20 *See Meram v. Citizens Title & Trust, Inc.*, 2011 WL 11463, at \*5 (S.D. Cal. Jan. 3, 2011).

21 **II. Plaintiffs’ Claim For Aiding And Abetting Breach Of Fiduciary Duty Fails**

22 Plaintiffs’ claim for aiding and abetting breach of fiduciary duty fails for the same reasons  
23 articulated above. Because the aiding and abetting claim sounds in fraud, it must be pled with

24  
25 <sup>8</sup> *See, e.g., Janney v. Mills*, 944 F. Supp. 2d 806, 818 (N.D. Cal. 2013) (“Rule 9(b) requires that  
26 the plaintiff(s) identify specific advertisements and promotional materials [and] allege when the  
27 plaintiff(s) were exposed to the materials”); *Kearns*, 567 F.3d at 1226 (“Nowhere in the  
28 [complaint] does Kearns specify . . . when he was exposed to [the representations] or which ones  
he found material. Kearns also failed to specify which sales material he relied upon in making his  
decision to buy . . . . Accordingly, these pleadings do not satisfy the requirement of Rule 9(b.”);  
*Arroyo v. Chattem, Inc.*, 926 F. Supp. 2d 1070, 1080 (N.D. Cal. 2012) (“nowhere does Plaintiff  
allege when, where, or how she was exposed to . . . advertising, or marketing prior to purchase.”).

1       particularly subject to Rule 9(b). *See, e.g., Siegal v. Gamble*, 2016 WL 1085787, at \*9 (N.D.  
2       Cal. Mar. 21, 2016) (applying Rule 9(b) to claim for aiding and abetting breach of fiduciary duty,  
3       where “fraud is the gravamen” of the claim); *In re Ditech Networks, Inc. Derivative Litig.*, 2008  
4       WL 820705, at \*6 (N.D. Cal. Mar. 26, 2008) (same).

5       Plaintiffs reincorporate the same allegations and allege that PayPal knew that Scoville  
6       breached fiduciary duties to Traffic Monsoon’s customers based on its knowledge of certain  
7       account activities including the commingling of funds, statements on Traffic Monsoon’s website  
8       that it offered advertising and revenue sharing services rather than investments, and Scoville’s  
9       failure to disclose to customers that PayPal had shut down several of his prior accounts. Compl. ¶  
10      196. These allegations are nearly identical to the allegations made in support of Plaintiffs’ aiding  
11      and abetting fraud claim, and they are no more adequate to plead either actual knowledge or  
12      intentional and substantial assistance of the alleged breach of fiduciary duty than they are to plead  
13      the same required elements of fraud. In short, both counts rely on the false premise that PayPal  
14      should bear responsibility for Scoville’s alleged frauds and breaches of fiduciary duty simply  
15      because, prior to investigating and limiting Traffic Monsoon’s account, PayPal allowed Scoville  
16      to do business with it. There is no support in California or federal case law for that extreme  
17      position.

18       Plaintiffs’ aiding and abetting breach of fiduciary duty claim fails for an additional reason.  
19       As discussed above, “a defendant can only aid and abet another’s tort if the defendant knows what  
20      ‘that tort’ is.” *Casey*, 127 Cal. App. 4th at 1146 (citation omitted). This means that in cases  
21      involving aiding and abetting a breach of fiduciary duty, the plaintiff must plead specific facts  
22      showing that the defendant knew that the alleged primary wrongdoer *owed a fiduciary duty to the*  
23      *plaintiff*. But Plaintiffs plead no facts establishing that PayPal knew that Scoville owed fiduciary  
24      duties to purchasers of AdPacks. They instead make the conclusory allegation that “PayPal was  
25      aware that Traffic Monsoon and Scoville were fiduciaries” because PayPal supposedly knew that  
26      purchasers of AdPacks were “investors.” Compl. ¶ 195. However, Plaintiffs have not alleged  
27      any facts to show that PayPal knew that Traffic Monsoon’s AdPack product constituted an  
28      “investment” in a security, or that purchasers of AdPacks were in fact “investors” of securities,

1 and thus there is no basis to conclude that PayPal had actual knowledge of Traffic Monsoon's  
2 alleged fiduciary duties to AdPack purchasers.

3 **III. Plaintiffs' Claim Under Cal. Corp. § 25504.1 Fails**

4 Under section 25504.1 of the California Corporations Code, any person who "materially  
5 assists" in a violation of section 25401 of the Code, "with intent to deceive or defraud, is jointly  
6 and severally liable with any other person liable" for the violation. Section 25401, in turn, makes  
7 it unlawful "for any person to offer or sell a security in this state, or to buy or offer to buy a  
8 security in this state, by means of any written or oral communication that includes an untrue  
9 statement of a material fact or omits to state a material fact necessary to make the statements  
10 made, in the light of the circumstances under which the statements were made, not misleading."  
11 Because a claim under section 25504.1 sounds in fraud, it must be alleged with particularity  
12 pursuant to Rule 9(b). *See Kainos Labs., Inc. v. Beacon Diagnostics, Inc.*, 1998 WL 2016634, at  
13 \*16 (N.D. Cal. Sept. 14, 1998).

14 Plaintiffs' section 25504.1 claim fails because they fail to allege that Traffic Monsoon  
15 offered or sold securities by means of false or misleading statements "in this state," that PayPal  
16 "materially assisted" Traffic Monsoon in selling or offering to sell securities by means of false  
17 and misleading statement, or that PayPal did so with "an intent to deceive or defraud."

18 **A. Plaintiffs Fail To Allege An Offer Or Sale Of A Security In California**

19 "[I]n section 25401 the [California] Legislature expressly limited the scope of the  
20 prohibition of false or misleading statements in an offer to buy or sell. That section makes it  
21 'unlawful for any person to offer or sell a security *in this state*.'" *Diamond Multimedia Sys., Inc.*  
22 *v. Super. Ct.*, 19 Cal. 4th 1036, 1054 (1999); *see also MTC Elec. Techs. Co. v. Leung*, 876 F.  
23 Supp. 1143, 1147 (C.D. Cal. 1995) ("In order to have a valid cause of action under . . . § 25401  
24 MTC must allege that there was a sale or purchase of stock in California"). An offer or sale of a  
25 security is made "in this state" if: (1) an offer is made from California to a person outside the  
26 state; (2) an offer is made from outside California to a person inside the state; (3) a contract of  
27 sale is formed by an acceptance directed to a person in California; or (4) the certificate or other  
28 evidence of the security is directed to a purchaser inside California and both the purchaser and the

1 seller are domiciled in California. Cal. Corp. Code § 25008(a)-(b).

2 Plaintiffs and the other members of the alleged class cannot satisfy the “in this state”  
3 requirement, as they admittedly all “resided outside the United States at the time of their  
4 investment in Traffic Monson,” and Traffic Monsoon is a Utah limited liability company that  
5 promoted its AdPack “investments” from Utah. Compl. ¶¶ 36, 163; Ex. 7 at 28. Accordingly,  
6 Plaintiffs cannot establish a primary violation of section 25401, and their section 25504.1 claim  
7 must be dismissed. *See Wallack v. Idexx Labs., Inc.*, 2013 WL 5206190, at \* 12 (S.D. Cal. Sept.  
8 12, 2013) (“Since Plaintiff has failed to adequately allege the underlying section 25401 claim, his  
9 claim as to section 25504.1 also fails as to all Defendants.”).

10 **B. Plaintiffs Fail To Allege Facts Showing That PayPal “Materially Assisted”  
11 Traffic Monsoon’s Alleged Violation Of Section 25401**

12 Plaintiffs’ section 25504.1 claim further fails because they do not allege any facts showing  
13 that PayPal “materially assisted” Traffic Monsoon in its alleged violation of section 25401. As  
14 the California Court of Appeal has emphasized, “[t]he plain language of section 25504.1 makes  
15 clear that a person must have materially assisted *in* the securities law violation.” *Arei II Cases*,  
16 216 Cal. App. 4th 1004, 1014 (2013) (emphasis in original). “Therefore, for purposes of section  
17 25504.1, it is not enough that a person provided material assistance in a larger scheme to defraud  
18 if that person had no role or involvement in the part of the scheme that constituted a violation of  
19 the securities laws.” *Id.* Just knowing or having “reason to know the facts constituting the  
20 violation” is also not enough for liability under section 25504.1. *Id.* at 1016.

21 Here, as in *Arei II*, the alleged primary violation is selling or offering to sell a security by  
22 means of false and misleading statements in violation of section 25401. *Id.* at 1015. Plaintiffs  
23 therefore were required to allege facts demonstrating how PayPal “assisted in the act of selling or  
24 offering to sell securities by means of false and misleading statements.” *Id.* at 1014-15; *see also*  
25 *Calderon v. Total Wealth Mgmt., Inc.*, 2016 WL 898823, at \*3 (S.D. Cal. Mar. 9, 2016)  
26 (“‘Allegations demonstrating how the defendant assisted in the act of selling or offering to sell  
27 securities by means of false and misleading statements’ are required.”) (citation omitted). But,  
28 like the plaintiffs in *Arei II*, Plaintiffs have not alleged any facts showing that PayPal “had any

1 involvement in selling or offering to sell" securities to Plaintiffs "by false and misleading  
2 statements." 216 Cal. App. 4th at 1018-19. Indeed, PayPal is not alleged to have had any  
3 communications with Plaintiffs, let alone to have made false or misleading statements to them.  
4 Nor is PayPal alleged to have played any role in the preparation, drafting, or distribution of any  
5 alleged false or misleading statement made to Plaintiffs. *Id.* at 1019.

6 Rather, PayPal is alleged to have assisted Traffic Monsoon's purported Ponzi scheme by  
7 allowing Traffic Monsoon to open and maintain a PayPal account through which it accepted  
8 payments for AdPacks. *See Compl. ¶¶ 180, 228.* However, Traffic Monsoon's creation and use  
9 of a PayPal account to transfer and hold proceeds from the sale of AdPacks is not a violation of  
10 section 25401. Section 25401 is only violated through the sale or offer to sell a security by means  
11 of false and misleading statements. And Plaintiffs do not allege that PayPal played any role in the  
12 preparation or maintenance of Traffic Monsoon's website, which contained the allegedly false  
13 and misleading statements and through which AdPacks were offered and sold. *See Compl. ¶¶ 37-*  
14 49, 69 ("Traffic Monsoon offered and sold the AdPacks through its website.").

15 **C. Plaintiffs Fail To Allege Facts Showing That PayPal Acted With An "Intent  
16 To Deceive Or Defraud" Plaintiffs**

17 Finally, Plaintiffs' section 25504.1 claim fails because they do not allege any facts  
18 showing that PayPal materially assisted Traffic Monson with an "intent to deceive or defraud."  
19 Cal. Corp. Code § 25504.1. "Intent to defraud is defined as the intent to induce reliance on a  
20 knowing misrepresentation or omission." *Schaffer Family Investors, LLC v. Sonnier*, 120 F.  
21 Supp. 3d 1028, 1045 (C.D. Cal. 2015) (citation omitted). The Complaint, however, does not  
22 allege any facts to show that PayPal intended to induce Plaintiffs to rely on representations known  
23 to be false or misleading. It merely alleges in utterly conclusory fashion that "PayPal materially  
24 aided, with intent to deceive or defraud, in the acts or transactions constituting violations" of  
25 section 25401. Compl. ¶ 227. That boilerplate allegation is nothing but a "formulaic recitation of  
26 a cause of action's elements" that, even under the lenient pleading standards of Rule 8(a), "will  
27 not do." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007); *see also Kainos*, 1998 WL  
28 2016634, at \*16 (dismissing section 25504.1 claim because plaintiff 'failed to provide with

1 requisite particularity allegations of fraudulent intent on the part defendants”).<sup>9</sup>

2 **IV. Plaintiffs' Claim For Negligence Fails**

3 Plaintiffs' fourth claim for negligence fails because Plaintiffs expressly released PayPal  
4 from liability for the injuries they suffered. Even if that was not the case, the claim still fails  
5 because it does not allege sufficient facts showing that PayPal owed Plaintiffs a legal duty to use  
6 due care in connection with Traffic Monsoon, and it is barred by the economic loss rule.

7 **A. Plaintiffs' Negligence Claim Is Barred By The PayPal User Agreement**

8 A valid written release may exculpate a tortfeasor from future negligence or misconduct.

9 *See Bennett v. U.S. Cycling Fed'n*, 193 Cal. App. 3d 1485, 1490 (1987). Although a liability  
10 release “must be clear, unambiguous, and explicit in expressing the intent of the parties,” it need  
11 not achieve perfection. *Paralift, Inc. v. Super. Ct.*, 23 Cal. App. 4th 748, 755 (1993). Rather,  
12 when “read as a whole, [it] must clearly notify the prospective releasor or indemnitor of the effect  
13 of signing the agreement.” *Ferrell v. S. Nev. Off-Road Enthusiasts, Ltd.*, 147 Cal. App. 3d 309,  
14 318 (1983). Moreover, the express language of the release determines its scope, but not every  
15 possible specific act needs to be spelled out in the agreement. *See Benedek v. PLC Santa Monica,*  
16 *LLC*, 104 Cal. App. 4th 1351, 1356 (2002) (“A release may negate the duty element of a  
17 negligence action.”).

18 Here, the PayPal User Agreement governing Plaintiffs' use of the PayPal services, which  
19 Plaintiffs necessarily accepted as a condition of becoming members of PayPal, expressly limits  
20 the scope of PayPal's duties and obligations vis-à-vis its users, and contains a clear and  
21 unambiguous release of liability in PayPal's favor for damages or losses resulting directly or  
22 indirectly from the content, actions or inactions of third parties like Traffic Monsoon and  
23 Scoville:

24 **1.1 PayPal is Only a Payment Service Provider.** PayPal helps you make payments to  
25 and accept payments from third parties. PayPal is an independent contractor for all  
purposes, except that PayPal acts as your agent with respect to the custody of your funds.

26 <sup>9</sup> Indeed, as discussed above, Plaintiffs' own allegations refute the notion that PayPal intended to  
27 defraud alleged AdPack investors. The Complaint alleges that PayPal limited Traffic Monsoon's  
28 account, established a telephone number for Traffic Monsoon customers to call to “address  
concerns,” and told some of them that Traffic Monsoon was a “scam.” Compl. ¶¶ 144-150.  
These actions are directly contrary with an “intent to defraud.”

1 PayPal does not have control of or liability for the products or services that are paid for  
2 with the Services. We do not guarantee the identity of any User or ensure that a buyer or a  
Seller will complete a transaction.

3 \* \* \*

4 **2.5 Third Party Permissions.** If you grant express permission to a third party to take  
5 specific actions on your behalf, or access particular information about your Account, you  
acknowledge that . . . You will not hold PayPal responsible for, and will indemnify PayPal  
from, any liability arising from the actions or inactions of the third party in connection  
with the permissions you grant.

6 \* \* \*

7 **15.1 Limitations of Liability.** IN NO EVENT SHALL WE . . . BE LIABLE FOR LOST  
8 PROFITS OR ANY SPECIAL, INCIDENTAL, INDIRECT, OR CONSEQUENTIAL,  
9 OR PUNITIVE DAMAGES . . . ARISING OUT OF OR IN CONNECTION WITH OUR  
WEBSITE, THE SERVICES, OR THIS AGREEMENT (HOWEVER ARISING,  
INCLUDING NEGLIGENCE), UNLESS AND TO THE EXTENT PROHIBITED BY  
LAW. . . . IN ADDITION . . . [PAYPAL IS] NOT LIABLE, AND YOU AGREE NOT  
TO HOLD [PAYPAL] RESPONSIBLE, FOR ANY DAMAGES OR LOSSES  
(INCLUDING, BUT NOT LIMITED TO, LOSS OF MONEY, GOODWILL, OR  
REPUTATION, PROFITS, OR OTHER INTANGIBLE LOSSES OR ANY SPECIAL,  
INDIRECT, OR CONSEQUENTIAL DAMAGES) RESULTING DIRECTLY OR  
INDIRECTLY FROM: . . . (E) THE CONTENT, ACTIONS, OR INACTIONS OF  
THIRD PARTIES[.]

14 Ex. 14. The above provisions are clear, unambiguous and explicit, and routinely enforced to  
15 dismiss negligence claims. *See, e.g., Darnaa, LLC v. Google, Inc.*, 2015 WL 7753406, at \*5  
16 (N.D. Cal. Dec. 2, 2015) (“Applying section 10 of YouTube’s Terms of Service, the court  
17 dismisses plaintiff’s [] cause of action [for negligence]”).

18 **B. Even If Plaintiffs Did Not Waive Their Right To A Claim For Negligence,  
19 PayPal Did Not Owe Them A Duty Of Care Vis-à-vis Traffic Monsoon And  
Scoville**

20 “The threshold element of a cause of action for negligence is the existence of a duty to use  
21 due care toward an interest of another that enjoys legal protection against unintentional invasion.”  
22 *Paz v. State*, 22 Cal. 4th 550, 559 (2000). Courts “invoke[] the concept of duty to limit generally  
23 the otherwise potentially infinite liability which would follow from every negligent act.” *Bily v.*  
24 *Arthur Young & Co.*, 3 Cal. 4th 370, 397 (1992) (internal quotation marks and citation omitted).  
25 As a result, courts should only create a duty where “clearly supported by public policy.”  
26 *Rowland v. Christian*, 69 Cal. 2d 108, 112 (1968). Plaintiffs here fail to establish that PayPal  
27 owed them a legal duty a care vis-à-vis Traffic Monsoon and Scoville for two reasons.

28 First, as noted above, PayPal is a payment service provider and as such has no legal duty

1 of care to supervise account activity, inquire into the purpose for which funds are being used,  
2 police accounts for wrongdoing or irregular transactions, disclose a customers' unusual banking  
3 activity, prevent commingling of assets in fiduciary accounts, or conduct an investigation of  
4 possible misappropriation of funds. Case law in the analogous depositor-bank context confirm  
5 this. *See Chazen v. Centennial Bank*, 61 Cal. App. 4th 532, 537-41 (1998); *see also Ghlachi v.*  
6 *U.S. Bank, N.A.*, 2015 WL 12655411, at \*8 (C.D. Cal. Apr. 29, 2015) (banks have no "duty to  
7 supervise account activity or inquire into the purpose for which the funds are being used," or "to  
8 police their fiduciary accounts," and "are not liable for a trustee's misappropriation of funds").  
9 PayPal owed no such duties to Plaintiffs with respect to Traffic Monsoon and Scoville.

10 Second, the Complaint pleads no facts sufficient to establish the existence of such a duty,  
11 even assuming the issue of whether PayPal had a legal duty to Plaintiffs was not already  
12 foreclosed by the case law governing a bank's duties to its depositors. In determining whether  
13 policy considerations weigh in favor of imposing a legal duty of care, courts balance the *Rowland*  
14 factors: (1) the foreseeability of harm to the plaintiff; (2) the degree of certainty that the plaintiff  
15 suffered injury; (3) the closeness of the connection between the defendant's conduct and the  
16 injury suffered; (4) the moral blame attached to the defendant's conduct; (5) the policy of  
17 preventing future harm; (6) the extent of the burden to the defendant and consequences to the  
18 community of imposing a duty to exercise care with resulting liability for breach; and (7) the  
19 availability, cost, and prevalence of insurance for the risk involved. 69 Cal. 2d at 113.

20 Here, the Complaint sets forth no facts upon which this Court can impose a duty on  
21 PayPal to protect Plaintiffs from Traffic Monsoon and Scoville, and the *Rowland* factors dictate  
22 the opposite result. First, the harm to Plaintiffs as a result of Traffic Monsoon's alleged Ponzi  
23 scheme cannot be said to have been sufficiently foreseeable by PayPal where the issue of whether  
24 the business of Traffic Monsoon even legally constitutes a Ponzi scheme is still up for debate, as  
25 recognized by the Utah Court's certification of an interlocutory appeal to the Tenth Circuit.  
26 Second, while Plaintiffs have allegedly suffered economic injury, the degree to which they have  
27 is uncertain given Traffic Monsoon and Scoville's assets have been frozen by the Utah Court, are  
28 controlled by the receiver, and have yet to be distributed to alleged victims of the Ponzi scheme.

1           Third, the connection between PayPal’s conduct and Plaintiffs’ injury is remote. As  
2 articulated above, PayPal had no involvement in Traffic Monsoon’s alleged Ponzi scheme or  
3 business. PayPal neither promoted Traffic Monsoon nor gave it an air of legitimacy, but instead,  
4 acted only to process payments to and from Traffic Monsoon—a service that it markets and  
5 provides widely to other merchants as well around the world. Indeed, as discussed above, the  
6 PayPal User Agreement—which Plaintiffs agreed to—makes clear that PayPal merely acts as a  
7 “custodian” of user funds and “does not have control of or liability for the products or services  
8 that are paid for with [PayPal’s] services.”

9           Fourth, the moral blame attached to PayPal’s alleged conduct is minimal; rather, the moral  
10 blame for any financial losses suffered by Plaintiffs lies entirely with Scoville and Traffic  
11 Monsoon. Fifth, the “overall policy of preventing future harm is ordinarily served, in tort law, by  
12 imposing the costs of negligent conduct upon those responsible,” *Kesner v. Super. Ct.*, 1 Cal. 5th  
13 1132, 1150 (2016) (citation omitted), and in the present factual scenario, Scoville and Traffic  
14 Monsoon, the alleged perpetrators of the Ponzi scheme, not PayPal, are the responsible parties.  
15 Finally, imposing a duty on PayPal and other online payment service providers to intensely  
16 monitor, investigate and curb all alleged fraud when no obvious indicators of fraud exist would be  
17 extensive, and in any event, those extra costs will be borne by the consumer. *See, e.g., Software*  
18 *Design & Application v. Hoefer & Arnett*, 49 Cal. App. 4th 472, 483 (1996) (“Scrutiny into the  
19 financial and business affairs of prospective customers for the express purpose of ferreting out the  
20 faithless fiduciary and divining illegal conduits for embezzled funds would be intrusive for the  
21 citizenry and add to the cost of financial transactions, both in terms of time and money.”).

22           **C. Plaintiffs’ Negligence Claim Is Also Barred By The Economic Loss Rule**

23            “[P]laintiffs may recover in tort for physical injury to person or property, but not for  
24 purely economic losses.” *S.F. Unified Sch. Dist. v. W.R. Grace & Co.*, 37 Cal. App. 4th 1318,  
25 1327 (1995). Since Plaintiffs’ alleged damages are economic (Compl. ¶¶ 185, 203, 211, 219,  
26 229), the economic loss doctrine bars their negligence claim. *See Spencer v. DHI Mortg. Co.*,  
27 642 F. Supp. 2d 1153, 1161 (E.D. Cal. 2009).

28            California courts recognize an exception to this doctrine only if a “special relationship”

1 exists among the parties. *ExxonMobil Oil Corp. v. Nicoletti Oil, Inc.*, 713 F. Supp. 2d 1105, 1113  
2 (E.D. Cal. 2010). To determine whether a special relationship exists, the California Supreme  
3 Court in *J'Aire Corp. v. Gregory* instructed courts to examine six factors: “(1) the extent to which  
4 the transaction was intended to affect the plaintiff, (2) the foreseeability of harm to the plaintiff,  
5 (3) the degree of certainty that the plaintiff suffered injury, (4) the closeness of the connection  
6 between the defendant’s conduct and the injury suffered, (5) the moral blame attached to the  
7 defendant’s conduct, and (6) the policy of preventing future harm.” 24 Cal. 3d 799, 804 (1979).  
8 “In order to survive a motion to dismiss, a claim for negligence based on a special relationship, a  
9 claimant must allege facts sufficient to support the existence of a special relationship.”  
10 *ExxonMobil*, 713 F. Supp. 2d at 1113.

11 Plaintiffs here allege no such facts. Indeed, Plaintiffs have failed to allege a relationship  
12 between PayPal and Plaintiffs that goes beyond those envisioned by everyday transactions. *See*  
13 *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 968-69  
14 (S.D. Cal. 2014) (no “special relationship” beyond “those envisioned in everyday consumer  
15 transactions, and therefore, negligence is the wrong legal theory on which to pursue recovery for  
16 Plaintiffs’ economic losses”). Moreover, for the reasons discussed above, all of the *J'Aire* factors  
17 weigh against a finding of a “special relationship” between PayPal and Plaintiffs.

18 **V. Plaintiffs’ Claim For Gross Negligence Is Not Cognizable**

19 Plaintiffs’ claim for gross negligence fails because “California does not recognize a  
20 distinct common law cause of action for gross negligence apart from negligence.” *Jimenez v. 24*  
21 *Hour Fitness USA, Inc.*, 237 Cal. App. 4th 546, 552 n.3 (2015); *Grappo v. McMills*, 11 Cal. App.  
22 5th 996, 1014 (2017); *Architectural Res. Grp., Inc. v. HKS, Inc.*, 2013 WL 568921, at \*5 (N.D.  
23 Cal. Feb. 13, 2013) (dismissing gross negligence claim because “California courts do not  
24 recognize a separate cause of action for gross negligence”).

25 **CONCLUSION**

26 For these reasons, the Complaint should be dismissed.

1 Dated: September 7, 2017

2 ORRICK, HERRINGTON & SUTCLIFFE LLP

3 /s/ James N. Kramer

4 James N. Kramer

5 Attorneys for Defendants PayPal, Inc. and PayPal  
6 Holdings, Inc.

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